March 28, 2017

Mr. David Bean, Director of Research and Technical Activities  
Project Number 3-251  
Governmental Accounting Standards Board  
401 Merritt 7, P.O. Box 5116  
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Submitted via email to director@gasb.org

Dear Mr. Bean:

Thank you for the opportunity to provide these comments regarding the Invitation to Comment of the Governmental Accounting Standards Board (GASB, the Board) on major issues relating to Financial Reporting Model Improvements – Governmental Funds (the “ITC”). The Board is to be commended for taking this initial step toward potential improvements to the existing financial reporting model for governmental funds. I appreciate this opportunity to respond and my comments reflect my views as a former government finance officer and a current academician responsible for teaching undergraduate and graduate level courses in governmental accounting and auditing. My response is prefaced with a few general comments followed by responses to the specific questions raised in the ITC.

Overall Comments

Measuring and accounting for transactions in governmental funds is, in my opinion, difficult, at least initially, for many users of governmental financial statements to understand. Complicating this understanding is the dual approach used for external financial reporting which encompasses fund level and government-wide information where different measurement focuses and bases of accounting are used for governmental funds. This is especially problematic for government officials as the fund level information they use on a day-to-day basis for decision making is most often based on budgeted amounts or some level of fund information. Because this information is in some cases markedly different from the government-wide information, it becomes difficult for a government to successfully make a case they are fulfilling their duty to be publicly accountable. Therefore, I support the Board’s attempt to make improvements to the financial reporting model that might minimize this confusion.

It appears confusion among some stakeholders about the time perspective covered by the information in fund level statements for governmental funds is one of the factors considered in the development of the ITC (page vii). I am a bit puzzled as to why the ITC notes the “governmental fund financial statements may not clearly communicate to all users of financial statements that the information presented is limited to a shorter time perspective…” The requirements for information presented in the Management’s Discussion and Analysis (MD&A) include a discussion of the basic financial statements and the relationships between them as well as significant differences in the
information provided. In addition, notes to the financial statements are required to disclose a description of the government-wide statements and the measurement focus and basis of accounting used in preparing those statements as well as information relating to revenue recognition in governmental funds. Therefore, my conclusion is perhaps this user group is not reading the MD&A and/or the notes to the financial statements. In my opinion, the required information is adequate to understand what is reported and for what time frame.

Concepts Statement No. 1 of the GASB, Objectives of Financial Reporting, acknowledges users of government financial statements have various levels of understanding about governmental accounting and finance. With respect to public accountability, Statement No. 1 further states financial reports should be understandable to users not having a detailed knowledge of accounting (par. 63). Statement No. 1 also notes users of government financial information are a diverse group with potentially diverse needs but the information provided in the general purpose financial reports should generally be based on the common needs of the users (par. 72). However, I believe the proposals in this ITC put far more emphasis on the needs of the investor/creditor user group than the citizen and/or legislative/oversight bodies groups.

From what I can conclude from the ITC, it appears the investor/creditor user group may be the impetus for some of the proposals discussed therein. With respect to this user group, I would ask the Board to consider the characteristic of understandability in Concepts Statement No. 1 similar to this same characteristic in Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting – Chapter 1, The Objective of General Purpose Financial Reporting and Chapter 3, Qualitative Characteristics of Useful Financial Information, of the Financial Accounting Standards Board (FASB). The FASB’s understandability characteristic states “…financial reports are prepared for users having a reasonable knowledge of business and economic activities and who review and analyze information diligently” (par. QC32). If this concept is considered applicable to the investor/creditor user group of governmental financial statements, I believe the Board would need to only consider potential changes to the governmental funds financial reporting model affecting the citizen and legislative/oversight bodies user groups.

I am providing the following demographic information to assist in evaluating the need for and potential usefulness of the proposed alternatives to the current governmental fund financial reporting model and to put my responses in context. The following information is taken from the 2012 Census of Governments conducted by the U.S. Census Bureau and available at www.census.gov/govs/cog/.

- Of the 90,056 local governments surveyed, 43% and 57% represent general purpose governments (38,910 counties, municipalities, and townships) and special purpose governments (33,031 single function and 5,235 multiple function), respectively.
- 12,249 independent school districts (kindergarten/elementary through secondary) represent 24% of the special purpose governments and 14% of all local governments.
- Ten states make up 50% and 46% of the general purpose and special purpose governments, respectively. These states are California (second largest number of special purpose governments), Illinois (largest number of local and special purpose governments), Kansas, Minnesota (second largest number of local governments), Missouri, New York, Ohio, Pennsylvania, Texas, and Wisconsin.
• All of the top ten states require all or some local governments to prepare external financial statements using either all, most, or some of the required generally accepted accounting principles (GAAP).

• Based on population, 95% of the local governments (37,132) surveyed have a population of less than 50,000 and 91% of the local governments (35,490) have a population of less than 25,000. 83% of local governments have populations of less than 10,000.

• 93% of the independent and dependent school districts have enrollments of less than 10,000 students. 85% of these school districts have enrollments of less than 5,000 students.

• Using the midpoint of the enrollment categories and the 2014 national average for per pupil spending of $11,009 (Annual Survey of School System Finances, U.S. Census Bureau), this equates to school districts with budgets of approximately $1,100,000 to $82,600,000 for 93% of the independent and dependent school districts. Using the districts in the 85% level, budgets range from approximately $1,100,000 to $41,300,000.

• Most independent and dependent school districts (42%) are in the 1,000 to 2,499 (24%) and 500 to 999 (18%) enrollment categories.

• Over half (52%) of the 38,266 non-school district special purpose governments represent entities involved in natural resources (7,468), utilities (6,486), and fire districts (5,865).

This demographic information leads me to conclude the vast majority of local governments and school districts are not large and many are in fact very small. Typically, smaller governments have limited personnel with the expertise in the accounting and finance functions necessary to prepare financial statements in accordance with GAAP. In addition, it is highly likely these governments, who have a large stake in the proposals outlined in the ITC, are unaware of the ITC or its potential to impact their fund accounting systems for governmental funds.

Even though a large number of local governments are small, there may still be a requirement to prepare external financial statements using GAAP. Your own research indicates less than half of the states require local governments to prepare GAAP financial statements and you estimate approximately 70% of county and local governments prepare financial statements using GAAP. This may be because many bond agreements require the issuer to prepare annual financial statements using GAAP as do a number of financial institutions providing funding to local governments. Therefore, the proposals outlined in the ITC will have a major effect on a large number of local governmental entities.

In my experience, many state and local governments invest the majority of their human, capital, and financial resources in front line services and related capital rather than in support functions. As such, accounting and finance staff in these entities may have limited knowledge of accounting and financial reporting requirements relating to state and local governments. To compensate for this lack of internal expertise, governmental entities often engage their external auditor to assist them in preparing their external financial statements. When auditors assist in preparing the external GAAP financial statements, the effect of this nonattest/nonaudit service on the auditor’s independence is required to be evaluated under professional auditing standards.

I realize the Board is an accounting standard setting body rather than an auditing standard setting body; however, the increasing complexity of governmental accounting standards is making it
necessary for many small and medium-sized governments to rely more and more on their auditor to ensure their financial statements are prepared in accordance with GAAP. Due to the increasing complexity of governmental accounting standards and the improvements discussed in the ITC, it may be necessary at some point in the future for the auditor to conclude management does not have the requisite knowledge, skills, and experience to effectively oversee the financial statement preparation process. In such cases, the auditor’s independence is impaired and he/she is required to refuse to accept a new engagement or to resign from an existing engagement.

Few elected officials use the external financial statements for internal decision making because of the differences in the internal (typically budget-based) information and financial statements prepared in accordance with GAAP. In addition, the long period of time between the end of the fiscal period and the availability of the external financial statements usually makes the reported information obsolete for effective decision making for all user groups. Part of this delay is due to the effort involved in converting day-to-day decision based fund information to what is required by GAAP for external financial reporting. The level of the auditor’s assistance in preparing the financial statements may also contribute in delaying the issuance of the external financial statements.

Questions for Respondents

Question 2.1

Without doubt, I strongly believe governmental fund financial statements should continue to present information reflecting a shorter time perspective than the information presented in the government-wide statements. Based on my experience as a government finance official, I strongly believe fund level information is the day-to-day budget-based information used for decision making by management and elected officials. As such, the shorter time perspective of these statements reflects the government’s budgetary performance and assists in meeting the public accountability objective of governmental financial reporting. Regardless of their financial acumen, taxpayers will not typically support funding public goods and services beyond the annual/biennial budget cycle.

Question 2.2

I whole-heartedly believe governmental fund financial statements should continue to present information which will facilitate comparisons with budgetary information. As stated above, I believe this information supports public accountability. It also provides information for citizens to use in assessing how well their government carried out the financial and operational plan approved in the budget setting process and ultimately documented in the budget. As a policy document, compliance with the budget may help financial statement users assess the government’s ability to determine if the government “put their money where their mouth is”.

In many local governments, there is significant focus on the approval portion of the budget process where the proposed budget and accompanying tax rates are published and discussed at often multiple required budget hearings. Unfortunately, there is not nearly the interest in the evaluation
portion of the budget process which is why I believe the fund financial statements (which are often audited) should facilitate comparisons with budgetary information.

**Question 2.3**

The near-term financial resources approach provides the most relevant information for assessing fiscal accountability as it relates to the current reporting period. I also believe the near-term approach is the best attempt at providing a consistent conceptual foundation on which to develop future accounting standards. In addition, the near-term approach is closest to the financial resources/modified accrual approach currently in use and as such, would likely require less time and effort to implement its requirements. The assets and liabilities and inflows and outflows of resources recognized under the near-term approach more faithfully represent the intent of the elected officials which is documented in the adopted budget.

The short-term and long-term approaches are extremely complex and do not appear to align with the budget. As such, information reported under these two approaches would not represent the reality associated with public budgeting and the resulting accountability therefore. Taxpayers are not usually concerned with the financial resources a government may need in the short and long term because they want to minimize the taxes they need to pay in the current period to provide services in the current period. While these approaches may be more attractive to the investor/creditor user group, they do not faithfully represent public accountability because the time perspective is inconsistent with the budgetary time perspective.

**Question 2.4**

Inherently, tax and revenue anticipation notes are near-term resources when received and consume near-term resources when they are repaid. Therefore, the near-term approach provides the most valuable information to users of the financial statements and is more conceptually sound than the short-term or long-term approach. In actuality, many tax and revenue anticipation notes are often assumed and repaid within the same budget cycle because they are needed only for short-term liquidity needs.

Under current GAAP, any unpaid tax or revenue anticipation notes are reported as liabilities in the governmental funds because, in theory, they are to be liquidated with available current financial resources. Such reporting is, in fact, conceptually inconsistent. Reporting both the proceeds and repayment as inflows and outflows, respectively, of resources is conceptually sound and is not likely to present any significant cost to implement such changes. The challenge discussed in paragraph 19 (a) on page 11 relating to accrued interest is most often irrelevant because tax and revenue anticipation notes issued through a financial institution are often discounted. Therefore, there is no accrued interest because the financial institution discounted the note upon inception.

The short-term and long-term approaches are extremely complex and do not appear to represent the reality of many of these types of borrowings (see discussion of demographics in the Overall Comments section above). Accounting for tax and revenue anticipation notes under the short-term and long-term approaches adds several levels of complexity to what are, for most governments, straightforward decisions and relatively simple transactions to report in the financial statements.
While these approaches may be more attractive to the investor/creditor user group, they do not provide information useful for decision making in most cases. The challenge noted in paragraph 19 (b) on page 11 relating to governments balancing their budgets by issuing tax or revenue anticipation notes, or not making required pension contributions, would be reflected in the government-wide statements. If such transactions were budgeted under these circumstances, the short-term and long-term approach would be inconsistent with the budgetary intent (regardless of how financially irresponsible it might be) and therefore would not faithfully present public accountability with the budget.

**Question 2.5**

When dealing with governmental funds, the entire focus of operations is on financial resources and I believe those financial resources to be primarily cash or cash equivalents. Items such as prepaid items and inventory do not, in my opinion, typically represent items available to be converted to cash. When such amounts are paid, I believe they represent outflows of resources in the current period because it is highly unlikely the government will request a refund of amounts paid or will return inventory items. While I can appreciate the view prepaid items and inventories can be converted to cash or are consumable in lieu of financial resources, it is not consistent with budgetary accounting and therefore does not accurately report public accountability.

In reality, the focus of public accountability for governmental funds is on the availability of revenues and other financial sources and how those resources are appropriated. For example, the budget for Public Works includes $10,000 for asphalt and to demonstrate public accountability the amount expended for inventory represents an outflow of financial resources. The fact there may be asphalt remaining in inventory at the end of the year is irrelevant in light of financial accountability. In theory, if there is inventory at the end of the current period, the appropriation in the subsequent period should be reduced for the amount currently on hand. However, in reality, budgets are prepared well in advance of the end of the period and many governments assume there will be no inventory at the end of the current period. Under the near-term approach, it appears it would be less confusing than the current approach for some financial statement users since no inventory and related nonspendable fund balance would be reported.

**Question 2.6**

As stated previously, I believe the near-term approach provides the most valuable information because it better represents public accountability. However, I am concerned the different circumstances triggering the recording of various liabilities might be confusing in its application and interpretation. I would suggest the “trigger” for reporting liabilities to be the same regardless of how the liability arose. For example, liabilities might be recognized using the criteria “any amounts due and past due at the end of the reporting period for which current financial resources are available, or will be available in the near term, to liquidate such liability”.

**Question 2.7**

While I support a same-page reconciliation to the government-wide statements, I do not believe the terminology used in the illustrative near-term financial statements provides much more insight
than descriptions currently used. Each of the three financial statement user groups is not likely to understand nomenclature such as “near-term” any better than the current nomenclature. Additionally, it is highly likely these users are not familiar with accounting concepts and nomenclature in general.

I would recommend a very plain English approach such as “Long-term assets are reported as expenditures when purchased in the governmental funds but as capital assets in the government-wide statements” and “Long-term assets acquired in prior years are not reported in the governmental funds in the current year”. Likewise, something similar to “Amounts paid on long-term debt are recognized in the governmental funds as expenditures but as reductions of recorded long-term liabilities in the government-wide statements”.

**Question 3.1**

The current format for the governmental funds resource flows statement provides the most valuable information about governmental funds. It very clearly and succinctly reports revenues and expenditures separate from other financing sources and uses which I feel provides more useful information to assess current period performance. For example, reporting interfund transfers as other financing sources and uses clearly indicates any level of subsidy received or provided, respectively.

I believe many users of government financial statements also use financial statements of nongovernmental entities. As such, I believe the statement of resource flows for governments should, as much as conceptually possible, follow the operating statement format used by nongovernmental entities. Therefore, I believe the headings used in the current and long-term activity format add a level of confusion for users with the use of the inflows and outflows nomenclature.

**Question 3.2**

Under the near-term approach, a statement of cash flows would be redundant because revenues and other sources and expenditures and other uses represent basically cash transactions. I do not support the short-term or long-term approaches but I can see why the ITC proposes a required statement of cash flows for each of these alternatives. Both of these approaches add complexity to reporting governmental fund information which is evidenced by needing an additional statement of cash flows to bring users back to what is reported in the near-term approach.

**Question 3.3**

If a statement of cash flows was required for the near-term approach, it would further lengthen the time needed to prepare and finalize the external financial statements in addition to it being redundant information. As noted above, I do not believe a statement of cash flows is necessary under the near-term approach. Both the preparation of the balance sheet and statement of revenues, expenditures, and changes in fund balance under the short-term and long-term approaches represent a significant increase in the time needed to prepare the external financial statements from the time needed now. Since these approaches include far more than cash transactions, a statement
of cash flows would be indicated. This would also add to the time needed to prepare the external financial statements under these two approaches.

**Question 3.4**

If a statement of cash flows was required for governmental funds, the format should be consistent with the current format prescribed in GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. Using the same format would likely be less confusing for the users of the financial statements. However, from a conceptual point of view, I can support a governmental fund statement of cash flows focusing only on operating cash flows because governmental funds inherently focus on operating from one budget cycle to the next.

**Conclusion**

To summarize my primary position on the proposed improvements to the financial reporting model for governmental funds, I believe the near-term approach best addresses the two objectives of external financial reporting for governmental funds. Because this approach is more aligned with the budget cycle and process it better reports public accountability. The information reported under this approach is also useful in assessing how well the government carried out its financial and operations plan. The short-term and long-term approaches provide far more complexity to reporting activities of governmental funds and the cost to provide such additional information will not, in my opinion, outweigh the public benefits of the additional information.

Conceptually, governmental financial statements attempt to meet the needs of a diverse group of financial statement users with various levels of knowledge of how governments operate and how to best report such operations in the external financial statements. As such, the current financial reporting model is complex, lengthy, and time intensive in its preparation. Notes to the financial statements are extremely long and in some cases repetitive. All of this combines to produce external financial statements that are daunting to most financial statement users. I strongly encourage the Board to remember most local governments in this country are small and already overloaded with the current financial reporting model requirements. In addition, I would ask the Board to consider stakeholder input from those user groups representing the majority of local governments in this country rather than those representing a small number of large governments.

As always, thank you for the opportunity to respond to this due process document. Should you have any questions regarding the above, please contact me at (407) 869-9254 or lkmdennis@gmail.com.

Sincerely,

Lynda M. Dennis, CPA, CGFO, PhD